

ONE ARTICLE FROM OER'S ECONOMIC INTELLIGENCE WEEKLY REVIEW  
ENDING 16 MARCH 1978. REQUEST ARTICLE BE PASSED TO AMBASSADOR,  
DCM, ECONOMIC SECTION AND OTHER WORKING LEVEL STATE OFFICERS.

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**BRAZIL: MANAGING A MASSIVE FOREIGN DEBT.**

1. HIGHER OIL BILLS HAVE BEEN MAINLY RESPONSIBLE FOR THE STEEP RISE IN BRAZIL'S FOREIGN DEBT--FROM \$13 BILLION AT YEAREND 1973 TO \$31 BILLION AT YEAREND 1977. THE LARGEST LDC BORROWER, BRAZIL HAS ACCOUNTED FOR ONE-FIFTH OF THE DEBT INCREASE OF ALL NON-OPEC LDCS OVER THE PERIOD AND IS NOW BURDENED BY DEBT SERVICE APPROACHING ONE-HALF OF ITS GOODS AND SERVICES EXPORTS. CONSIDERING THE HIGH RISK IN CONTINUED LARGE-SCALE BORROWING IN A PERIOD OF GLOBAL RECESSION, BRASILIA CAN TAKE CREDIT FOR ADROIT JUGGLING OF ECONOMIC GROWTH AND INTERNATIONAL PAYMENTS DEFICITS.

2. SINCE 1973, OBSERVERS HAVE EVERY SO OFTEN VOICED CONCERN THAT THE BRAZILIAN GOVERNMENT MAY BE MIRED TOO DEEP IN DEBT AND THAT OVERSEAS PRIVATE LENDERS MAY HAVE OVEREXTENDED THEMSELVES IN PLACING SUCH A LARGE VOLUME OF LOANS IN ONE COUNTRY. WE BELIEVE THE MOST RECENT SIGNS POINT TO IMPROVING ECONOMIC CONDITIONS AND GREATER CONFIDENCE ON THE PART OF FOREIGN BANKERS THAT THEIR OPTIMISM HAS BEEN WELL PLACED. LAST YEAR'S AUSTERITY MEASURES, WHICH CURBED THE CURRENT ACCOUNT DEFICIT BY NEARLY \$2 BILLION, HAVE HELPED BRING ABOUT THIS BETTERED OUTLOOK.

3. THROUGH 1980, WE EXPECT STRONG EXPORT GROWTH AND CONTINUED AUSTERITY MEASURES TO CONTAIN THE RISE IN TOTAL DEBT TO \$9 BILLION, WHILE REDUCING THE DEBT-SERVICE RATIO TO 44 PERCENT. UNDER THESE CIRCUMSTANCES, BRAZIL SHOULD HAVE

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LITTLE DIFFICULTY IN ATTRACTING NEW FOREIGN FUNDS. US LENDERS, WHO HOLD 60 PERCENT OF BRAZIL'S DEBT, WILL CONTINUE TO PROVIDE THE MAJOR SHARE, ALTHOUGH EUROPEAN AND JAPANESE CREDIT INSTITUTIONS WILL BECOME INCREASINGLY IMPORTANT.

#### DEBT BUILDUP.

4. BRAZIL HAS RELIED HEAVILY ON EXTERNAL BORROWING, MOSTLY IN PRIVATE CAPITAL MARKETS, TO FINANCE ITS AMBITIOUS ECONOMIC DEVELOPMENT PROGRAMS. AS A RESULT, TOTAL FOREIGN DEBT INCREASED FROM \$4 BILLION TO \$12.6 BILLION DURING 1968-73. DESPITE THIS RAPID DEBT BUILDUP, BRAZIL'S INTERNATIONAL CREDIT RATING REMAINED HIGH BECAUSE OF THE ECONOMY'S ENORMOUS DEVELOPMENT POTENTIAL, RAPID EXPORT GROWTH, COMPETENT ECONOMIC AND FINANCIAL MANAGEMENT, AND POLITICAL STABILITY.

5. DEMAND FOR FOREIGN LOANS EXPLODED FOLLOWING THE QUADRUPLING OF OIL PRICES IN 1973/74 AND THE RESULTANT DETERIORATION OF BRAZIL'S PAYMENTS POSITION. SIZEABLE CURRENT ACCOUNT DEFICITS WERE POSTED AS PRESIDENT ERNESTO GEISEL KEPT THE ECONOMY GROWING IN THE FACE OF WORLD RECESSION. GOVERNMENT AND PRIVATE BORROWING PERFORMANCE BALLOONED, PUSHING THE EXTERNAL DEBT TO ABOUT \$31 BILLION BY YEAREND 1977. THE PUBLIC SECTOR SHARE--IN THE FORM OF GOVERNMENT-GUARANTEED BORROWINGS BY STATE AND PRIVATE ENTITIES--TOTALLED ABOUT \$18 BILLION AND REPRESENTED MAINLY THE FINANCING OF INFRASTRUCTURE AND LARGE-SCALE DEVELOPMENT PROJECTS. FOREIGN PRIVATE DEBT WAS AN ESTIMATED \$13 BILLION, SOME \$3 TO \$5 BILLION OF WHICH CONSISTED OF SUMS OWED BY BRAZILIAN SUBSIDIARIES TO THEIR PARENT COMPANIES ABROAD. ABOUT ONE-THIRD OF PRIVATE DEBT IS DISGUISED AS INVESTMENT LARGELY FOR TAX REASONS.

6. INTERNATIONAL BANK LOANS AND EUROMARKET BORROWINGS ACCOUNTED FOR 72 PERCENT OF TOTAL LIABILITIES. SUPPLIER CREDITS ACCOUNTED FOR 9 PERCENT, WHILE OFFICIAL LENDING COMPRISED THE REMAINDER. US FINANCIAL INSTITUTIONS HELD 60 PERCENT OF THE DEBT.

--US COMMERCIAL BANKS HAD THE BIGGEST EXPOSURE, AT \$12.5 BILLION, THEIR FOURTH LARGEST IN ANY DEBTOR COUNTRY; US SUPPLIERS WERE OWED ANOTHER \$1 BILLION.

--THE US GOVERNMENT AND OTHER PRIVATE US CREDITORS ACCOUNTED FOR \$5.1 BILLION.

#### DEBT SERVICE BURDEN.

7. DEBT SERVICE OBLIGATIONS HAVE MOUNTED PROPORTIONATELY.

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PRINCIPAL AND INTEREST PAYMENTS SOARED TO \$6.5 BILLION IN 1977, COMPARED WITH \$2.5 BILLION IN 1973. DEBT-SERVICE PAYMENTS IN 1977 REPRESENTED 48 PERCENT OF EXPORT EARNINGS FROM GOODS AND SERVICES--UP FROM 35 PERCENT IN 1973. ALTHOUGH HIGH BY INTERNATIONAL STANDARDS, THE PRESENT DEBT-SERVICE RATIO IS TYPICAL OF BRAZILIAN RATIOS BEFORE THE COMMODITY EXPORT PRICE BOOM OF 1973-74.

#### DEBT MANAGEMENT POLICIES.

8. GENERALLY SPEAKING, INTERNATIONAL BANKERS HAVE BEEN FAVORABLY IMPRESSED BY BRAZIL -EBT MANAGEMENT POLICIES. NEVERTHELESS, BRASILIA'S EXTRAORDINARY DEMAND FOR FOREIGN CAPITAL AFTER 1973 RESULTED IN A GRADUAL TOUGHENING OF LOAN TERMS AND--IN SOME INSTANCES--CONTRIBUTED TO AN UNEASINESS AMONG BANKERS CONCERNING THE RESOLUTION OF THE GOVERNMENT TO REDUCE CURRENT ACCOUNT DEFICITS. AS A RESULT OF THESE CONCERNS, AVERAGE MARGINS ON BRAZILIAN EUROBORROWINGS INCREASED TO NEARLY 2 PERCENTAGE POINTS OVER THE LONDON INTERBANK OFFER RATE (LIBOR) BY LATE 1976. LOAN MATURITIES WERE ALSO REDUCED AND GRACE PERIODS SHORTENED.

9. THESE DEVELOPMENTS LED BRAZIL TO LIMIT ITS DEBT BUILDUP AND IMPROVE ITS BORROWING POSITION IN 1977. INITIAL EFFORTS FOCUSED ON TRIMMING THE CURRENT ACCOUNT DEFICIT, WHICH DECLINED BY ONE-THIRD. AS ONE RESULT, PUBLIC ANNOUNCED EUROCREDITS TO BRAZILIAN BORROWERS FELL 6 PERCENT, TO \$3.3 BILLION, IN 1977. STATE ENTITIES MADE FEWER SORTIES IN THE EURODOLLAR MARKET DURING THE YEAR, REFLECTING A 25-PERCENT CUT IN PUBLIC INVESTMENT SPENDING, CEILINGS ON PUBLIC SECTOR BORROWING, AND TIGHTER LOAN APPROVAL PROCEDURES. THE CENTRAL BANK FORCED A TEMPORARY DECLINE IN LOAN DISBURSEMENTS BEGINNING LAST NOVEMBER BY FREEZING ALL FOREIGN EXCHANGE PROCEEDS UNTIL JANUARY.

10. IN ADDITION TO THESE MEASURES, FINANCE MINISTER HENRIQUE SIMONSEN HAS BEEN SEEKING TO INCREASE THE MATURITY OF NEW LOANS AND GRACE PERIODS TO SLOW FURTHER THE GROWTH OF DEBT-SERVICE COSTS. AS A RESULT, DURING SECOND HALF 1977 MORE THAN 40 PERCENT OF NEW FOREIGN BORROWING CARRIED REPAYMENT PERIODS IN EXCESS OF FIVE YEARS; MOST CARRIED EIGHT-YEAR MATURITIES. RECENTLY, BRAZIL BROKE THE 10-YEAR BARRIER WITH A \$300 MILLION BANK OF AMERICA SYNDICATION. THE CENTRAL BANK WAS ABLE TO RAISE MINIMUM GRACE PERIODS FROM 6 TO 30 MONTHS IN MID-1977. BECAUSE BRAZILIAN LOAN DEMAND REMAINS STRONG, HOWEVER, BORROWERS ARE STILL PAYING UP TO 2 PERCENTAGE POINTS ABOVE LIBOR, SOMEWHAT HIGHER THAN SPREADS NOW EXTENDED TO SMALLER LATIN AMERICAN LDC BORROWERS.

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11. UNDER PRESSURE FROM SIMONSEN, GOVERNMENT AGENCIES AND BUSINESS FIRMS ARE ALSO DIVERSIFYING BORROWINGS WITH AN EYE TO REDUCING DEPENDENCE ON THE US CAPITAL MARKET. WEST EUROPEAN, JAPANESE, AND ARAB BANKS NOW COMPRISE 75 PERCENT OF INSTITUTIONS COMANAGING AND SYNDICATING NEW EURODOLLAR ISSUES TO BRAZIL.

12. BRAZIL IS ALSO BECOMING MORE ACTIVE IN THE INTERNATIONAL BOND MARKET TO TAKE ADVANTAGE OF FAVORABLE RATES. AS A RESULT, BOND ISSUES WERE \$710 MILLION IN 1977 COMPARED WITH \$270 MILLION IN 1976. ALTHOUGH 60 PERCENT WERE MARKETING IN THE UNITED STATES, BRAZILIAN ENTITIES INCREASED PLACEMENTS IN WEST GERMANY AND JAPAN AND FOR THE FIRST TIME HAVE APPROACHED THE SWISS AND THE SAUDI ARABIANS.

OUTLOOK THROUGH 1980.

13. IN VIEW OF BRAZIL'S FAVORABLE EXPORT PROSPECTS AND CONTINUING EFFORTS TO HOLD DOWN THE CURRENT ACCOUNT DEFICIT, WE EXPECT NET FOREIGN BORROWINGS AVERAGING ABOUT \$3 BILLION A YEAR DURING 1978-80. BRAZIL'S EXTERNAL DEBT THUS WILL CLIMB TO AN ESTIMATED \$40 BILLION BY YEAREND 1980. THIS ESTIMATE INCORPORATES THE FOLLOWING ASSUMPTIONS AND JUDGMENTS:

A ROUGH BALANCE OF EXPORTS AND IMPORTS IN 1978, REPLACED BY A \$900 MILLION SURPLUS BY 1980, AS EXPORT GROWTH OUTPACES THE INCREASES IN IMPORTS NEEDED TO SUPPORT ECONOMIC EXPANSION.

--A 28-PERCENT INCREASE IN DEBT SERVICE PAYMENTS, TO \$8.3 BILLION IN 1980.

--NO BUILDUP IN INTERNATIONAL RESERVES.

14. ALTHOUGH DEBT-SERVICE PAYMENTS WILL INCREASE SUBSTANTIALLY THROUGH 1980, THE DEBT-SERVICE BURDEN SHOULD EASE. BESIDES RAPID EXPORT GROWTH, THE CURRENT EFFORTS TO STRETCH OUT LOAN MATURITIES AND TO HOLD DOWN POINT SPREADS ARE THE PRIMARY FACTORS. AS A RESULT OF THIS BRAKE ON DEBT-SERVICING COSTS, THE PROJECTED 12-PERCENT ANNUAL INCREASE DURING 1978-80 IN EXPORT EARNINGS SHOULD TRIM THE DEBT SERVICE RATIO TO 44 PERCENT BY 1980.

15. BRAZIL'S EXPORT PROSPECTS ARE BRIGHT DESPITE A TEMPORARY FALL IN AGRICULTURAL EXPORTS THIS YEAR DUE TO LOWER PRICES AND RECENT DROUGHT DAMAGE. CONTINUED GROWTH IN SHIPMENTS OF SEMIFINISHED COMMODITIES AND MANUFACTURED PRODUCTS WILL POWER THE OVERALL EXPORT ADVANCE, REFLECTING

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THE IMPACT OF FISCAL INCENTIVES, AGGRESSIVE MARKETING, AND THE PENETRATION OF NEW MARKETS BY BRAZILIAN EXPORTERS. WE EXPECT EXPORTS OF INDUSTRIAL PRODUCTS WILL GROW BY 15 PERCENT PER ANNUM (IN NOMINAL TERMS), TO \$7.3 BILLION BY 1980. HIGHER PRICES, COMPLEMENTED BY MODERATE GAINS IN VOLUME, WILL BOOST EARNINGS FROM PRIMARY PRODUCTS; AGRICULTURAL COMMODITIES WILL ALSO CONTRIBUTE TO THE EXPORT ADVANCE AFTER 1978.

CREDITOR RESPONSE.

16. WITH THE EXPECTED IMPROVEMENT IN THE CURRENT ACCOUNT THROUGH 1980, BRAZIL'S ABILITY TO BORROW ABROAD ALMOST CERTAINLY WILL REMAIN STRONG. THIS YEAR MANY LARGE US BANKS--FOR EXAMPLE, MORGAN GUARANTY, CHEMICAL, BANK OF AMERICA, AND CHASE MANHATTAN--ALREADY ARE ACTIVELY SEEKING NEW BRAZILIAN LOAN OPPORTUNITIES. THIS REFLECTS:

--THE PROFITABILITY OF LENDING TO BRAZIL IN THE FACE OF SLACK LOAN DEMAND IN INDUSTRIAL COUNTRIES.

--BANKER CONFIDENCE IN THE GOVERNMENT'S ABILITY TO KEEP THE CURRENT ACCOUNT IN CHECK.

--THE ECONOMY'S LONG-TERM GROWTH AND EXPORT POTENTIAL.

17. BANKERS ARE NOW AGGRESSIVELY MARKETING EURODOLLAR LOANS FOR BRAZIL. DURING THE PAST THREE MONTHS, AN ESTIMATED \$1.3 BILLION HAS BEEN RAISED IN EUROMARKETS; AN ADDITIONAL 12 SYNDICATIONS ARE CURRENTLY BEING NEGOTIATED WITH LENDERS. RECENT SYNDICATIONS HAVE BEEN OVERSUBSCRIBED. ELECTROBRAS, THE STATE ELECTRICITY HOLDING COMPANY, HAD OFFERS OF 400 MILLION DEUTSCHE MARKS ON A LOAN REQUEST FOR 100 MILLION MARKS. LOANS ARE ALSO BEING MADE ON MORE FAVORABLE TERMS. THE NATIONAL DEVELOPMENT BANK LAST MONTH RECEIVED A \$300 MILLION US LOAN FOR 10 YEARS, WITH A THREE-YEAR GRACE PERIOD, AT LESS THAN 2 PERCENTAGE POINTS OVER LIBOR. A \$200 MILLION 10-YEAR LOAN IS NOW BEING NEGOTIATED AT 1.875 PERCENTAGE POINTS OVER LIBOR.

18. US BANKS AND INSTITUTIONS ARE ALSO FINDING INCREASED COMPETITION IN SUPPLYING FUNDS TO BRAZIL. IN EUROPE, LAST NOVEMBER, THE BRAZILIAN STEEL COMPANY, ACOMINAS, PULLED IN MORE THAN \$1 BILLION IN A FINANCING PACKAGE THAT INCLUDED \$505 MILLION IN EURODOLLAR AND DEUTSCHE MARK LOANS. AN EQUAL AMOUNT OF EXPORT CREDITS WERE EXTENDED FROM BRITISH, FRENCH, AND WEST GERMAN BANKS. JAPANESE BANKS HAVE ALSO

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25X1A EVIDENCED STRONG DEMAND FOR BRAZILIAN PAPER IN RECENT MONTHS.  
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ORIG & AUTH: ASA/D/OER/NFAC [REDACTED] REL: CH,NFAC/CS

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